(2)

No. 87-1791

In the Supreme Court of the United States

October Term, 1988

NORTHWESTERN NATIONAL INSURANCE COMPANY OF MILWAUKEE, WISCONSIN,

Petitioner,

vs.

MELLON BANK, N.A.,

Respondent.

Brief of Respondent Mellon Bank, N.A. In Opposition to the Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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COUNTERSTATEMENT OF FACTS

A. Introduction

As part of a loan transaction between respondent Mellon Bank, N.A. ("Mellon")[1] and Bates Energy Associates, Inc. ("Bates"), petitioner Northwestern National Insurance Company of Milwaukee, Wisconsin ("Northwestern") issued to Mellon a Financial Guarantee Bond ("Bond"), agreeing to pay Mellon a specified sum of money in the event that Bates defaulted on its obligations to Mellon. Bates defaulted: it failed to make the loan payment which became due and owing on October 1, 1985, and it failed to make any payment thereafter.

Following Bates' default, Mellon submitted two separate notices to Northwestern, the first one demanding payment of the two monthly payments which had become due on October 1, 1985 and November 1, 1985 ($108,391.94) and the later one demanding payment of all amounts due and owing under the Bond on an accelerated basis ($2,936,259.95).

Admitting its obligation to make payment to Mellon, but denying that Mellon had a right to demand payment on an accelerated basis, Northwestern paid to Mellon the sum of $451,587.87 on June 16, 1986. Northwestern has since failed and refused to pay any portion of the remaining balance due and owing to Mellon.

Mellon filed its Complaint in the United States District Court for the Western District of Pennsylvania, seeking to recover all amounts due and owing under the Bond. The District Court granted Mellon's Motion for Summary

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[1]Pursuant to Supreme Court Rule 28.1, Mellon's parent company is Mellon Bank Corporation.

Judgment and entered judgment in Mellon's favor. On appeal by Northwestern, the United States Court of Appeals for the Third Circuit heard arguments and thereafter affirmed the District Court's decision without an opinion. The case is now before this Court on Northwestern's Petition for Writ of Certiorari.

B. The Financial Guarantee Bond

Because the issues raised in this case depend so heavily upon the terms of the Financial Guarantee Bond, an understanding of the terms and conditions of the Bond is essential.

The Bond specified just one condition to Northwestern's obligation: the failure by *Bates* to pay all amounts due and owing to Mellon. It was *not* conditioned, as Northwestern assumes and argues, upon a failure by the shareholders to discharge their independent obligations to Mellon. The Bond itself provided as follows:

> "NOW, THEREFORE, the condition of this obligation is that if the corporation [Bates] makes all of the payments of the principal and interest and other sums in accordance with the Note and Security Agreement, then this obligation shall be null and void; otherwise it shall remain in full force and effect."
>
> A default was defined by the Bond as follows:
>
> " 'Default' shall mean failure by the Corporation [Bates] to make any payment under the Note and Security Agreement in accordance with its terms, regardless of whether the Corporation [Bates] for any reason shall be under no legal obligation to discharge its obligations to the Bank under the Note and Security Agreement."

The Bond set forth in some detail the procedure by which Mellon was to demand and then obtain payment from Northwestern. Following a default by Bates, the Bond provided that Mellon should demand payment by submitting to Northwestern, not to the shareholders, a Notice of Default containing certain specifically agreed upon information:

> "After a Default, written notice thereof shall be given to the Surety [Northwestern] by the Bank no later than sixty days after Default unless the Surety [Northwestern] agrees in writing to extend the time for filing such notice. Notice of Default shall include a signed statement stating the date payment was due under the Note and Security Agreement, that the Corporation [Bates] is in Default the aggregate amount due (whether by acceleration or otherwise) as of the date of the statement, the amount representing interest accruing each day and the rate at which such amount is computed, and that such aggregate amount has not been paid."

There were no other conditions to Northwestern's obligation:

> "The Surety [Northwestern] shall pay any sums due hereunder in immediately available funds no later than fifteen (15) days after the receipt of Notice of Default by the Surety [Northwestern] in accordance with Section 5."

Northwestern refers to a letter from Mr. Bouchat. The letter did not in any way change Northwestern's obligation. By stating that Northwestern is bonding the obligations of the shareholders, the letter merely reiterated the language of the Bond itself: the amount which Mellon was entitled to collect from Northwestern was not to exceed the total of

the amounts which are independently owed by the shareholders. The letter did not in any respect suggest that a new or different condition to Northwestern's obligation was intended.

By paying to Mellon the sum of $451,587.87 in these circumstances, Northwestern admitted that Mellon need *not* demand any payment from the shareholders and the shareholders need *not* be in default to Mellon before Northwestern's obligation arises. Northwestern's obligation arose out of and was dependent solely upon Bates' default.

WHY THE WRIT SHOULD NOT BE GRANTED

A. The Decision of the Third Circuit in This Case Does Not Conflict With the Decision of the Fourth Circuit Relied Upon By Northwestern

Northwestern argues first that the Court of Appeals for the Third Circuit held that ". . . the automatic stay created by 11 U.S.C. §362 does not extend to a contractual indemnitee of a debtor in reorganization, a holding in direct conflict with the decision of the United States Court of Appeals for the Fourth Circuit in *A.H. Robins v. Piccinin,* 788 F.2d 994 (4th Cir. 1986)." (Petition for Writ of Certiorari, at 17-18).

Northwestern makes two mistakes in advancing this argument. First, it misconstrues the decision of the Third Circuit: the Third Circuit did not hold that it would not, in an unusual situation, stay an action brought against a contractual indemnitee of a debtor in bankruptcy. The Court merely held that, in this case, Northwestern is not entitled to that protection.

Second, it also misconstrues the decision of the Fourth Circuit: the Fourth Circuit merely held that, in an unusual situation, such as the one presented in the *Robins* case, a Bankruptcy Court might stay an action against a non-debtor. It did not hold, as Northwestern suggests, that all proceedings against every contractual indemnitee must be stayed under Section 362.

The Fourth Circuit acknowledged that Section 362(a) is "... generally said to be available only to the debtor, not third party defendants or co-defendants." 788 F.2d at 999. Without reversing this general rule, it went on to state that, where there are "unusual circumstances" or in an "unusual situation", the Court may properly stay proceedings against certain non-bankrupt defendants. *Id.*

The *Robins* case is in no way analogous to the case at bar. Robins was "an involved and complex" situation involving more than 5000 cases filed by numerous parties. Here, just two cases have been filed and Bates, the debtor, is not a party to either.

In *Robins,* the Court was acting in response to the debtor's request to protect and preserve its assets. Here, the debtor has not complained about Mellon's action and it did not ask that Section 362 be invoked.

In *Robins,* the contractual indemnitee was an insurance company which found itself responsible for a large number of previously unidentified and unidentifiable product liability claims which had been or might be filed against the debtor. In this case, Northwestern's risk was very clearly defined and understood.

Mellon was not a party to the indemnification agreements which Northwestern claims to have had with Bates and the Bates shareholders and was not even aware of their

existence until they were disclosed in the pleadings in this action. Insofar as Northwestern's obligation to Mellon is concerned, those agreements should be and are irrelevant.

Northwestern admits that it entered into those indemnification agreements to protect it against ultimate loss to Mellon, guaranteeing that it "... would receive reimbursement for any payments made as surety on the Bond." (Petition for a Writ of Certiorari, at 8-9). Having demanded those agreements from third parties as a means of guaranteeing its recovery of all amounts it must pay to Mellon, Northwestern should not be permitted to argue that those agreements constitute a reason for not paying Mellon in the first place.

Northwestern also admits that it commenced an action "... against the Bates shareholders for reimbursement of the payments made to Mellon under the Bond." (Petition for Writ of Certiorari, at 11-12). If Bates is the "real party defendant" in this action against Northwestern, it is much more so in Northwestern's action against the shareholders, yet Northwestern did not seek relief from the stay before its filed that action.

The case here is easily distinguished from the situation which was presented in *Robins*. The fact that the Third Circuit affirmed the decision against Northwestern does not suggest that the Third Circuit and the Fourth Circuit are in conflict on this issue.

B. This Case Does Not Raise Any Other Important Questions of Federal Law

Northwestern argues that, as a surety, it is entitled to raise, as a defense to Mellon's claim, any defenses which could have been raised by the shareholders. Both the District Court and the Court of Appeals have already rejected

this argument as being without merit. It does not constitute an important question of federal law.

Once again the language of this particular agreement between the parties is critical to the decision on this question. Ordinarily, a surety bond makes a default by the principal a specific condition of the surety's obligation: in those situations, the surety is not obligated to pay unless the principal defaults first.

Here, the Financial Guarantee Bond was not conditioned upon a default by the shareholders. The Bond provided that, if Bates defaulted, Northwestern would pay Mellon within 15 days of its receipt of Mellon's demand. Mellon was not required to even notify the shareholders of Bates' default, and it did not do so here. When Northwestern made its partial payment to Mellon, Mellon had not made any demand upon the shareholders.

When Northwestern made its partial payment to Mellon, it refused to pay Mellon the balance of the amount demanded. (The only reason advanced for refusing to pay the balance was that Mellon did not have a right to accelerate the amount due and owing under the Bond. Mellon clearly had that right and Northwestern has not pursued this issue). Not even Northwestern would contend that any of the shareholders had raised defenses to Mellon's claim at the time. In fact, it was not for another 8 or 9 months that Northwestern became aware of the shareholders' claims against Mellon, Northwestern and a host of other parties. Northwestern had already breached its obligations to Mellon, and the breach continued during this entire period of time. Now that those claims have been raised, Northwestern seeks to use them as a shield against its own liability, gaining a benefit from its earlier breach.

The decision in *Rhode Island Hospital Trust National Bank v. Ohio Casualty Insurance Co.*, 789 F.2d 74 (1st Cir. 1986) is inapposite to this action and does nothing to advance Northwestern's claim. The Court of Appeals in that case dealt with a discrete issue: the preclusive impact of a prior default judgment. Here, the principals have not obtained judgments against Mellon on their debt. The Bates shareholders have raised no defenses nor any claims for affirmative relief against Mellon with regard to the Bond. Rather, in the Ohio lawsuit they have raised generally stated affirmative claims for money damages against numerous third party defendants, including both Northwestern and Mellon.

Contrary to Northwestern's arguments, neither the District Court nor the Court of Appeals made a definitive ruling on any of the claims or defenses raised in the other proceeding. The District Court merely held that Northwestern had an obligation to pay Mellon a specified sum of money. Mellon's liability to the Shareholders, and Northwestern's liability as well, will be determined by the District Court of Ohio.

CONCLUSION

For the foregoing reasons, the Writ of Certiorari should not be granted.

Respectfully submitted,

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